

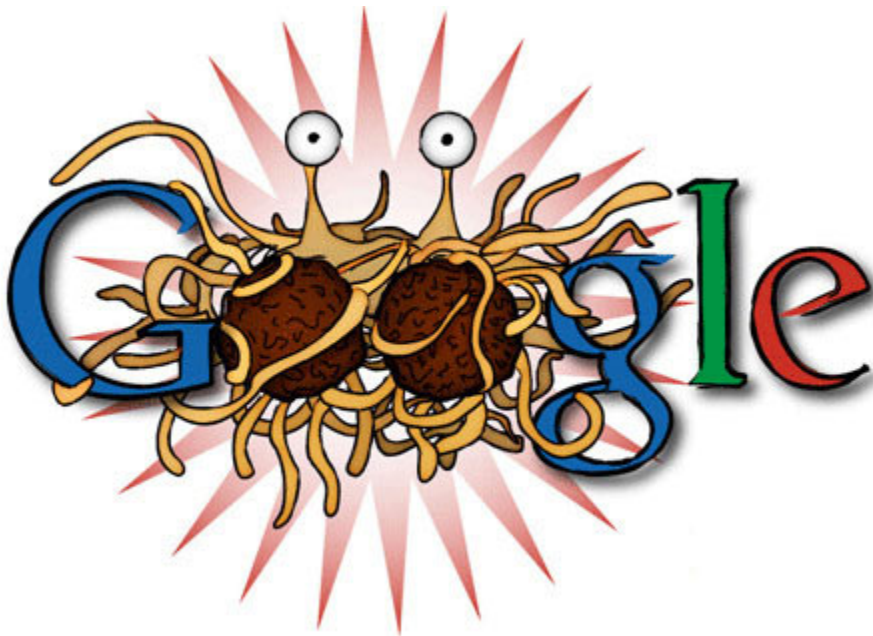
# THE FIGHT FOR DIGITAL SOVEREIGNTY: INDUSTRIAL FACTORS

*Up to some ten years ago, the debates about Internet governance were restricted to questions of Internet architecture – root management, domain naming, etc. – and that was quite sufficient at the time to guarantee Net neutrality. Today, as we observe that networks have become the backbone of our very existence and, indeed, of entire sectors of our economies, and also the platform incorporating numerous innovations, the underlying questions must be extended considerably. Industrial strategies, the ways and means to opportunely seizing power on the Internet itself have diversified, to the point that the question of net governance can no longer be limited to the facilities, viz., the bottom layer of the Internet. There now exists an Internet that sidesteps both the Internet and the world-wide-web. Facebook, Twitter or AppStores now represent private spheres with considerable impact on the way we live. What we are witnessing are de facto monopolies; and the advent of new very sophisticated ways to gain market slots, via what is called user-experience, for example. In order to guarantee Internet neutrality, we must reconsider the status of this peculiar public sphere that had developed from the original Internet.*

## **An economy for giants**

If we compare the current digital economy with the digital revolution that began in the 1990s, the difference is quite striking. The 1990s was a decade of start-up effervescence, with strong competition raging among them. Some of them have turned into today's Internet giants. Many companies closed down. The digital economy was dominated by the rapid emergence of these start-ups who disrupted complete market segments. The digital scene was totally open but today it comes under the rule of a few giants who rose to the event and prospered, often surfing on the speculative bubble of that decade, and gaining a dominant

position on world markets. Politicians and industrialists alike must take the changed scene seriously into account. We are no longer faced with a bunch of young geeks enjoying a DIY party in the back of a garage, but with real captains of industry who play the game with several moves ahead on the chessboard of global economy. In the space of just a few years, Google Corp. has become the second most influential lobbyist in the USA.



Moreover, these Internet giants are all very young and highly reactive. They never seem to become mature. They continuously change their business model, spread to new markets, reinvent their core products and revise their price lists. Their economy is always at the frontier of innovation, constantly demanding a reinvention – through innovation – of the areas where they can make profits from gains in productivity enabling them to pursue their development progress. America's digital giants are always innovating and no longer content themselves with the domestic US markets, but preferably the global market. Could we imagine setting up a European Google? This would prove illusory, to the extent that Google holds its dominant position in the world market-places and leaves no margin at all for intruders! What we have to imagine and create is an after-Google world.

The game, nevertheless, is not over yet. The American transformed those markets that in fact were the easiest to transform, those where the core business by essence is immaterial: publicity, catalogue sales companies and industries with contents such as music, film, audiovisual products or print (books). They took early footholds on these markets and gained precious knowhow into how to transform a given sector into a digital format.

However, the new, upcoming transformations will be of a completely different nature. We shall not just be moving from a CD to mp3 sound, but the digital transformation of hard sectors with a much more stringently regulated environment, such as the banks, insurance companies, transport or health infrastructures which are far more difficult to transform than either publicity or the music sector. Many opportunities remain open and the writing is not yet on the wall. There is nothing that specifically dictates that these sectors will be ruled tomorrow by American firms.

### **A European giant?**

What conditions would be necessary and sufficient to assure the emergence of future industrial giants? This is a question notably for Europeans but also for the larger emerging countries. It is not easy to come up with an answer, inasmuch as the political economic levers are not those of an economy trying to catch up with the rest of the field. Europe has made some progress in recent decades and today stands at the frontiers of innovation. But there is no overarching model left. In a trailing economy, we can witness the creation *in vitro*, by mimicry, of companies developed mainly on the basis of public subsidies and via national protectionism to bring them up to the innovation frontier. A good example here is Airbus Industries and we see observe that the Chinese are tempted by this approach, through massive technology transfer operations. But, in a digital economy, things just do not happen like this.

There are three main options. *Firstly*, we could use the lever of *start-ups*. To date, regrettably, Europeans have not been in a position to transform their *start-ups* into industrial giants. In this light, Europe should ask itself relevant questions about capital risk markets, about its labour laws, about segmentation of the domestic markets and the cultural gaps that exist.

*Secondly*, the major companies could perhaps form and provide leverage. Could, for example, Axa become the world leader in digital assurance? Could Vinci do likewise for the world's public works sectors? Transformation of industries of this size runs into all sorts of inertia, but the American companies show that taking the risk pays off. Amazon is a good illustration: it succeeded its transformation, first becoming a giant in e-commerce before becoming a giant in cloud computing and archiving. Likewise for Apple which today hardly resembles the original company, as it was back in the 1980s. But we can note also that not all large-scale companies are capable of operating such radical transformations.

The *third option* relates to the SMEs: could they, we wonder, constitute a lever? Could they transform their business model in time to be reborn as future champions in the making?

In the various scenarios set out above – but all the more relevant for the star-ups – the question of financing the venture is central to their success. The US company Amazon, between being registered at Wall Street SE and the end of 2003, burned 3 billion \$US. To be honest, those were the days of the speculation bubble, but more recently we saw Facebook also burn up 1.5 billion \$US between its corporate creation and its entry to Wall Street. This gives the order of magnitude of what it costs for a very small company to become a giant. The amount is less than the annual profits of a company like Orange, but far in excess of what European companies can raise. It calls for investors with high patience, far-reaching financial markets that can enable the protagonists to gain industrial positions. The US companies can rely on these assets

and can therefore buy out innovative technologies at the right time. Opportunities come and go, fast. Google only had to acquire – for 3 billion \$US – the commercial rights to a smart thermostat, to gain a foothold in the building and energy sectors, occupying a downstream, close-to-market advantage before moving upwards and eliminating one after another the traditional competitors in these sectors. Google is also showing interest for tomorrow's cars. A company like this, can move into a market through making an acquisition with its huge capital asset, putting to good use its huge capital assets, its important software know-how and its privileged contacts with users round the world; this way Google can make the difference from the outset this way and thereby get increasingly ahead of the field and stay in front.

If the issue of start-ups is intimately tied to economic finances, to capital risk possibilities, in contradistinction, that for major groups enjoys a closer relationship to political decisions. Today the dialogue between political authorities and top management of the majors is not focused on innovation and radical changes. It is a situation that can (and must) evolve. The questions that relate to the SMEs are more legal in aspect: bankruptcy rights, inter-enterprise relationships, creditors and shareholders? Should it be allowed to sink or should an effort be made to revive the company under new management, with new shareholders?

These are just some of the industrial policy instruments that are not currently clearly identified *per se*. For public policy decision makers, there is a distinction between an industrial policy on one hand and financing the economy on the other. It is noteworthy that both aspects here come under the responsibility of a different government minister. Financing of the economy is not seen as an instrument to modulate an industrial policy. Notwithstanding, it is a prime necessity, albeit only to help certain start-ups emerge correctly and to have the opportunity to become industrious giants in the future.

### **War coffers**

So, where exactly are the financial war coffers in a digital economy? In

the 1990s, it was assumed the money was stashed away in the networks with the telecomm operators central to the scene, then came the turn of the software packages before a return to equipment innovation, as was seen with the advent of *smartphones*, notably. Following suit came the view that the profit core was in the contents – which explains the strategy of a corporation such as *Vivendi*. More recently, the gathering of personal data has become a central theme and issue and leads on to another question: how can one gain confidence in a digital economy and assure protection of our personal data.

Industrial power in a digital economy is now not concentrated in organized structures but more in a multitude of connected individuals. Those enterprises that are gaining in power are those that have managed to instil privileged relationships with a multitude of users and ‘enrolling’ them in the corporate value chain. The core business of digital-intensive companies no longer lies in technologies but first and foremost in the relationships with their customers. Gathering personal data therefore is an instrument used to consolidate these relationships. The data serves to know the customers better and thereby to serve them better. It is not just a fluke that the digital economy today is dominated by American companies: it is in the country’s culture to place the priority on quality of service and on the attention paid to individual customers. This is not the case (and far from it) elsewhere in the world. With this prospect ‘round the corner’, so to speak, gathering personal data has become a major industrial policy question. We would be mistaken in only seeing it as a way to instrument the users, or to have them become tailored publicity targets. The digital giants do not collect data for solely publicity uses but to improve the quality of the services they offer. We would be wrong in stigmatizing the value capture techniques and what amounts to ‘theft’ of personal data. What must be borne in mind is that customers *do* make choices: they give to the company and the company returns the gesture by way of the service requested. Likewise, the over 700 000 downloadable “apps” in the Apple Appstore are the result of the equivalent of 500 000 engineer.years of work upstream and which benefit, at no cost, to the mother company. Apple did not pay for them

or acquire rights – they just take 30% of the turnover represented by the “apps” downloaded. These charitable engineers certainly *gave* to the company Apple, but the latter provided their extremely efficient platform and an access to a market they could never have hoped for before.

Consequently, if we should not see this relationship to users as that of a predator, public authorities are not under an interdict to intervene, for example, by helping in the case of collective negotiations. When it comes to data retrieval, the interesting feature is their ‘massive’ characteristic. The fact that we can be geo-localized when we go to a given restaurant in town has practically no interest at all but, in contradistinction, the aggregation of similar data allows you to study food intake habits over a long period. So, rather than see the process as that of a predator, it would prove more astute to work at harmonizing collective negotiation among peoples, multitudes, crowds and the platform. If people are ready and willing to contribute, they will also benefit.

Protection of our personal data – under these conditions – constitutes a lever for the framing of an industrial policy, provided that the approach be devised and designed as an industrial policy. In a legal framework where individuals come under high protection, the enterprises that inspire confidence re those who really are attentive to the clients and this being particularly true in a digital economy. It must be seen as a challenge for companies such as those of the banking sector, the insurance companies, the telecomm operators or transport companies. One must therefore inspire enough confidence to obtain the users’ consent to access and use their personal data. This is where we touch on cultural and sociological phenomena. It is through prioritizing the relationship with the users that we can hope to see new industrial giants arrive on the scene.

### **Possible public action?**

Public authorities in the future in France will have to address these

questions. They would go about this task in a different manner if there are no digital world-class champions, in the specifically French sociological environment. Industrial power considerations also represent a sovereignty-related challenge. The term ‘sovereign’ is not used very often in Europe, since there can be a confusion with outdated forms of protectionism. However, a digital world authorises novel forms of sovereignty which are mobile, transactional, dynamic... In the United States, *a contrario*, there is a highly resilient sovereignty policy; the American digital universe benefits from strong public support and from a multiple co-operations – we can think of the role played by the US Darpa (Defense Advance Research Project Agency) in the Defence area, along with a coherent strategy of soft power.

The history of the digital world is a succession of battles. In the beginning there was the battle for microprocessors, that Europe lost, followed by the battle of operation systems (OS), which was also lost, but Europeans did resist in the battle for telecoms... until the smartphone arrived. Other battles will follow and, in an area such as smart objects or the city of the future, the war is neither won nor lost, as yet. The important point is to gain a foothold in the market arena, to transform technological high-flying achievements into business models capable of being extended to a global scale.

It is primordial that public policy decision-makers understand the challenge and adopt the means and measures needed to accompany and encourage business enterprises that might become tomorrow’s giants. On a European scale, this calls for a real cultural revolution. Indeed, we cannot overemphasize the need to make in-depth transformations in order that companies may gain market positions. Our current trend is to adopt laws and regulations that are designed, so to speak, to slow down and dampen the enthusiasm of newcomers to the market place where the established enterprises might take offense and feel they are under threat. In the USA, innovation wins the day not because the dominant enterprises fully exercise their right to lobby in favour of their cause and bring pressure on the regulatory agencies but also because the innovators



who want to enter the markets are very agile, plus the fact that they have grouped themselves together and have the capacity to intervene, even in politics, massively financing (as is permitted) certain election campaigns. In Europe, this sort of balance of power simply does not exist. Innovators are few and far between, unknown entities, and not very present at all in our corridors of power. And should they be impudent to the point of criticizing the majors, they quickly realize that their heads are being shoved to the bottom of the bathtub.

This cultural revolution must be accompanied by an appropriate mobilisation of existing tools: the right to compete, freedom of speech, and efficiency of public action. After all, one of the key issues is the development of global monopolies. Public tools have existed for a century now in the USA to combat monopolies and the European Union has also become a specialist in adopting and enforcing anti-monopolistic procedures.

Nothing precludes returning to basic principles – public liberty, liberty of the press – opening the way to self-enforcement with standards that could be exported – we recall what Germany did in the decade 1980-1990 to recycle wastes or to prohibit dioxins. Further attention to collecting and using personal data could prove to be an advantage if only we learn how to proceed.

In fact we do not sufficiently consider Internet as a public sphere and we often underestimate certain attacks on individual freedoms that we not accept in a physical public sphere. In a similar manner to that which dictates why and how large ships conquer the oceans, we simply cannot hope to control the Internet without having relevant means, failing which there is a constant risk of loss of sovereignty that will leave countries in a state of incapacity to assure a reasonable protection of private lives or to prevent the arrival of *de facto* monopolies.

Fiscal measures are among the instruments that States have at their disposal, but if we do not introduce some radical changes here, they may

prove inadequate. A central question must be addressed if we wish to see relevant fiscal policy decisions: what was the source of the added value that contributes to the profits of a large enterprise? If we ignore the important question of transfer prices, we still tend to estimate that value lies in tangible assets, or intellectual property rights, in short on everything that is deemed inside the enterprise perimeter. And all of this amounts to an outdated vision: in a digital economy, corporate value now lies increasingly in other parameters.

The factors that contribute to corporate value are no longer within the company bounds; they are also to be found at the fringe, on the user-side, in the active agents of the company's value chain. Major digital enterprises echo these observed facts, but the persons in charge of drafting fiscal policies have not yet taken this on-board. How then should fiscal measures be adapted to accommodate the factors constitutive of a digital economy? The question, as such, is easy to formulate but a lot of work remains to make a common diagnosis, and here the diagnosis really needs to be shared. Answering the question is the objective of the BEPS mission (BEPS: OECD acronym for Base Erosion & Profit Shifting a major plan to prevent tax base erosion and profit transfer) but is also under examination by a group of experts instated at the European level, following the initiative taken by EC Commissioner Semata.

Fiscal measures alone cannot correct the imbalance. And yet they do carry with them the well-known incidence effects that occur in micro-economies. Taxes are most often passed on by the tax-payers to other actors in their eco-system. In the USA, Amazon – for a growing number of countries – is under the obligation to collect taxes on sales.

Traditional outlets, for which Amazon represents competition, saw this decision as a victory. Notwithstanding, Amazon was able to turn the situation to its advantage by multiplying the number of sites in each country so as to be able to offer same-day delivery. Fiscal measures here – as with any other disturbing factor in a system – strengthen the strong and weaken the weak.

Having said this, fiscal policy is also revelatory. Global companies create value in these countries but the host States recover nothing or next to nothing by way of added value tax returns. This situation should ring an alarm bell. Every business enterprise will try, whatever the sector, to minimise their tax liability in countries where they have not installed their home-office. However fiscal measures do not produce the same effects in digital activities compared with other sectors, since all the champions are American. To illustrate this point in the banking sector, we see that optimization works both ways since the other countries also have large bank establishments. By contrast, all the majors in the digital market today are Americans.

Over a long period, public authorities were able to enforce regulations and recommendations on companies seen to become too powerful and whose activities were essential for the economy as a whole. But the question now is not only how to control the giants, but to face up to the competition they offer. It is striking to note how close the guideline principles for major platforms with so-called Rolland's Laws – that theorised on the main principles of public service, *viz.*, continuity, mutability, equality. The major platforms have understood clearly that their industrial success entails offering continuous service and mutability which designated their capacity to upgrade when needed to follow technological change – the applications must therefore adapt to changing operating systems ; lastly, they place all users of a same level – anyone, for instance, can open an account with Apple and create an application.

This cultural feature implies that everyone becomes involved, *i.e.*, in a scenario where aggregation of forces is a challenge not only for business companies, but also for public authorities. The day is not so far ahead when we shall see some of the larger platforms contesting these authorities as to their prerogatives, proposing service connections tomorrow as, for example has already been done in England, or going as far as proposing to collect inland tax revenues (as has already been done for other taxes)... It is indeed urgent that we think seriously about such questions, failing which, there is definite risk of being unconsciously

drawn to abandoning certain degrees of sovereignty and in an irreversible manner. Citizens today are now conscious and appreciative of the difference they can enjoy between services offered on major Internet platforms and the rigid, slow, red-tape procedures rife in public service outlets. Therein lies a real challenge for public authorities, who must upgrade themselves, if they choose to preserve their sovereignty.

Source : <http://www.paristechreview.com/2014/06/30/digital-sovereignty/>